Supreme Court, U.S.
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No. _____

In the

Supreme Court of the United States

October Term, 1998

GERALD J. STOIBER,

Petitioner,

-v-

UNITED STATES SECURITIES AND EXCHANGE COMMISSION,

Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

PETITION FOR WRIT OF CERTIORARI

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68 pp

QUESTIONS PRESENTED FOR REVIEW

I. Did the Securities and Exchange Commission and Court of Appeals improperly shift the burden of proof in the proceedings below from the National Association of Securities Dealers, Inc. to the Petitioner by treating the presumption created in *Reves v. Ernst & Young*, 494 U.S. 56 (1990) as an affirmative defense rather than a true presumption?

II. Are the particular promissory notes in this case properly considered "securities" under the test established in *Reves v. Ernst & Young*, 494 U.S. 56 (1990)?

III. Does the fine imposed by the Securities and Exchange Commission violate the Excessive Fines Clause of the Eighth Amendment to the United States Constitution?

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I. Opinion of the United States Court of Appeals for the District of Columbia Circuit in *Stoiber v. Securities and Exchange Commission*, 161 F.3d 745 (1998).

II. Opinion of the Securities and Exchange Commission in *In the Matter of the Application of Gerald James Stoiber*, Securities Exchange Act Release No. 34-39112, 65 SEC Docket 1309 (September 22, 1997).

III. Opinion of the Securities and Exchange Commission in *In the Matter of the Application of Gerald James Stoiber*, Securities Exchange Act Release No. 34-39565 (January 22, 1998).

JURISDICTION

The decision of the United States Court of Appeals for the District of Columbia Circuit was entered on December 8, 1998. No petition for rehearing was filed by Petitioner. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254.

STATUTE AND REGULATIONS INVOLVED

I. Securities Exchange Act of 1934, § 3(a)(10), 15 U.S.C. § 78c(a)(10):

The term 'security' means any note, stock, treasury stock, bond, debenture, certificate of interest or participation in any profit-sharing agreement or in any oil, gas, or other mineral royalty or lease, any collateral-trust certificate, preorganization certificate or subscription, transferable share,

investment contract, voting-trust certificate, certificate of deposit, for a security, any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or in general, any instrument commonly known as a 'security'; or any certificate of interest or participation in, temporary or interim certificate for, receipt for, or warrant or right to subscribe to or purchase, any of the foregoing; but shall not include currency or any note, draft, bill of exchange, or bankers acceptance which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited.

II. Art. III, § 1 of the NASD Rules of Fair Practice:

A member, in the conduct of his business, shall observe high standards of commercial honor and just and equitable principles of trade.

III. Art. III, § 40(a) and (b) of the NASD Rules of Fair Practice:

(a) Applicability. No person associated with a member shall participate in any manner in a private securities transaction except in accordance with the requirements of this section.

(b) Written Notice. Prior to participating in any private securities transaction, an associated person shall provide written notice to the member with which he is

associated describing in detail the proposed transaction and the person's proposed role therein and stating whether he has received or may receive selling compensation in connection with the transaction; provided however that, in the case of a series of related transactions in which no selling compensation has been or will be received, an associated person may provide a single written notice.

IV. U.S. Const., Amdt. 8:

Excessive bail shall not be required, nor excessive fines imposed, nor cruel and unusual punishments inflicted.

STATEMENT OF THE CASE

I. Facts Material to Consideration of the Questions Presented

Petitioner, Gerald Stoiber, is a stock and commodities broker associated with American Investment Services, Inc. ("AIS") in Tinley Park, Illinois.

In approximately February, 1991, Stoiber had an idea for a commodities trading strategy he wanted to implement in his personal commodities account. Stoiber did not then have sufficient liquid assets to implement his strategy, so he decided to borrow the necessary funds. Stoiber was also interested in borrowing at that time to pay down the mortgage on his home, pay off credit card debt, and pay hospital bills.

Stoiber's borrowing efforts began by meeting with James Burgauer, the Director of Compliance of AIS. Stoiber advised Burgauer that he wanted to borrow some money to

pay personal expenses and also to implement a commodities strategy in his personal account. Stoiber told Burgauer that his intention was to borrow the funds he needed from friends who also happened to be his customers. Stoiber wanted to make sure the transactions were handled properly. Stoiber inquired of Burgauer whether there was any kind of rule prohibiting him from borrowing money from customers. There was no such rule. Burgauer advised Stoiber that he should document any loan with a promissory note, and provided Stoiber with a promissory note form that Burgauer had obtained from an attorney on one of his own personal matters. Although Burgauer's recollection of the conversation was less sharp than Stoiber's, Burgauer confirmed that the conversation had taken place essentially as stated by Stoiber.

Following his discussions with Burgauer, Stoiber contacted his parents and a small number of long-time friends who had previously loaned him money in order to borrow the money he needed. Stoiber met with the potential lenders personally, and there was not any sort of blanket mailing or other public solicitation for funds.

The friends Stoiber contacted had known him for an average of 9.3 years. Some of the friends contacted by Stoiber had known him for more than thirty years since junior high school. Stoiber had lived and worked in the Tinley Park area his entire life. Stoiber had an extremely close relationship with some of the friends. For example, Stoiber likened his relationship with Katherine Fleck to the kind of relationship one might have with a grandmother. Stoiber testified:

> I'm the one that meets her on Mother's Day, and I'm the one who she calls when she

> has a problem. I'm the one that is basically her family. * * * I take them to the Cub game. I make sure they get to bingo. I make sure they get their groceries.

Stoiber met with each of the lenders at their homes at least once or twice a year. He had played football with the son of one of the lenders. As to the other lenders, Stoiber testified:

> Nine out of ten people have had dinner at my house, had been to my kids' graduation, births or baptisms, will have lunch with me, dinner with me, send the kids gift certificates or presents for their birthdays.

All of the friends Stoiber contacted maintained securities accounts with him at AIS.

Stoiber's discussions with his parents and friends resulted in all of them agreeing to loan him money. Each of the friends agreed to loan Stoiber money on an unsecured basis pursuant to a standard form of promissory note, the form Stoiber had obtained from Burgauer. Such a loan is termed a "character" loan or signature loan. Promissory notes were duly executed and delivered to each of the friends. All of the notes provided for acceleration and recovery of attorneys' fees upon default. All of the notes provided for periodic payments of interest. The interest rates and the amounts borrowed differed from one lender to another, but the notes were identical in all other respects. Interest was generally set at 2% above what was then the prime rate. A total of $495,000 was borrowed by Stoiber in this manner, excluding $50,000 borrowed from Stoiber's parents.

Stoiber used the borrowed funds in precisely the manner he told the lenders he intended. The funds were initially deposited in a joint account held by Stoiber and his wife. Some of the funds were used to pay down the mortgage on Stoiber's home, to pay off credit card debt, and to pay off hospital bills. All told, about $50,000 of the borrowed funds were used for such household living expenses. The balance of the borrowed funds were transferred to Stoiber's personal commodities account at AIS and used to implement the commodities trading strategy he had developed. Once the borrowed funds were in Stoiber's household and commodities accounts, Stoiber did not segregate the funds loaned by the particular investors as one would expect if those funds represented investments instead of loans.

Stoiber faithfully made interest payments on the loans. Some of the loans were rolled-over when principal came due. None of the loans ever went into default.

In late 1993, the National Futures Association ("NFA") conducted a commodities review of AIS. In the course of its review, the NFA was made aware of Stoiber's loans. The NFA examiner made a telephone call to the National Association of Securities Dealers, Inc. ("NASD") to advise the NASD about the notes. The NASD's Senior Compliance Examiner, Raymond Giff, then undertook an investigation of the matter. The State of Illinois was also contacted, and it too commenced an investigation.

On April 16, 1994, the NASD commenced disciplinary proceedings against Stoiber, charging him with violation of Article III, § 40 of the NASD Rules of Fair Practice. Article III, § 40 requires brokers working for an NASD member firm to seek permission in writing before they sell securities away

from the member firm. The rule also requires the firm to consent in writing before the broker can proceed with any such sales. No charges were filed as to the loans from Stoiber's parents presumably because they were not evidenced by notes. As is the custom of the NASD, it also charged Stoiber with a separate and distinct violation of Article III, §1 although the alleged violation of Article III, § 1 was based on exactly the same conduct.

On May 16, 1995, a hearing was conducted before the NASD's District Business Conduct Committee for District 8. During the course of the hearing, the following facts material to this Petition for Writ of Certiorari were established:

- Each of the lenders considered the loans character loans and not investments.

- The lenders had not been misled by Stoiber in any way.

- None of the lenders filed any complaint or expressed any concern with Stoiber or his conduct.

- The NASD admitted it had no evidence to dispute the contention of Stoiber and the lenders themselves that the lenders viewed these transactions as mere loans and not investments in securities.

- The NASD admitted that there was no common scheme for offering the notes to the general public, and also that there was no market for trading of the notes.

- Stoiber never led the lenders to believe they would share in any profits he might earn on his commodities investments, and the NASD admitted that the lenders did not share in the account.

- Stoiber has continued to pay on the notes, and none of the notes has ever been in default.

- Stoiber's payments were not intended to vary with the profitability of the trading and they have not been influenced by the trading.

- When Stoiber was contacted by the NASD about the loans, he immediately expressed his belief that they were merely loans, and not securities subject to regulation by the NASD, and continued to do so throughout this matter. Stoiber did not even believe it to be a gray area.

- Mr. Burgauer likewise did not believe the notes were securities, nor that it was necessary for Stoiber to obtain prior written consent for these loans. Mr. Burgauer maintained that belief throughout the proceedings even after reviewing the *Reves v. Ernst & Young* case many times himself.

As indicated above, the State of Illinois also investigated this matter. The State of Illinois never made a determination as to whether the notes were securities. Instead, the Illinois investigation was resolved by Stoiber agreeing without admitting liability to offer rescission to the lenders. Stoiber did so under the supervision of the State of Illinois. None of the lenders accepted Stoiber's rescission

offer. Instead, all of the lenders signed reaffirmation agreements, the text of which had been approved by the State of Illinois.

On July 31, 1995, the NASD issued a decision concluding that Stoiber had violated Article III, §1 and 40 of the NASD Rules of Fair Practice. The NASD censured Stoiber and fined him $50,000 and required him to repay within 60 days the principal on the notes.

Stoiber appealed the adverse decision of the NASD. On March 22, 1996, the NASD's National Business Conduct Committee issued a decision affirming the findings of violations and increased the fine from $50,000 to $450,000 but provided that the fines shall be reduced by any amounts paid to the lenders within 60 days of the date of its decision. On April 25, 1996, Petitioner requested review of the NASD's decision by the Securities and Exchange Commission ("SEC") pursuant to 15 U.S.C. §78s (d)(2).

On September 22, 1997, in a 3-to-1 vote, the SEC issued a decision affirming the NASD's findings of violations and the increased sanctions the NASD had imposed. Commissioner Hunt dissented from the SEC decision, stating he was unable to determine on the record before him whether or not the instruments in question were securities. Stoiber filed a Petition for Reconsideration, which was denied. Petitioner then appealed to the Court of Appeals for the District of Columbia Circuit.

On December 8, 1998, the Court of Appeals dismissed Stoiber's Petition for Review of the Decision of the SEC. In its Opinion, the Court of Appeals rejected Stoiber's argument that the SEC had improperly shifted the burden of proof to

him in the disciplinary proceedings below, and held as a matter of law that the particular promissory notes at issue were "securities" under the test established in *Reves v. Ernst & Young*, 494 U.S. 56 (1990).

II. Basis for Federal Jurisdiction in the Court of First Instance

Petitioner appealed to the Court of Appeals for the District of Columbia Circuit pursuant to 15 U.S.C. § 78y.

REASONS FOR GRANTING THE WRIT

I. THE COURT OF APPEALS DECIDED AN IMPORTANT FEDERAL QUESTION IN A WAY THAT CONFLICTS WITH A RELEVANT DECISION OF THIS COURT BY TREATING THE PRESUMPTION ESTABLISHED IN *REVES v. ERNST & YOUNG* AS AN AFFIRMATIVE DEFENSE RATHER THAN AS A TRUE PRESUMPTION. MOREOVER, THIS TREATMENT DEPARTS SO FAR FROM THE ACCEPTED AND USUAL COURSE OF JUDICIAL PROCEEDINGS IN BOTH SECURITIES CASES AND NON-SECURITIES CASES AS TO CALL FOR AN EXERCISE OF THIS COURT'S SUPERVISORY POWER.

The burden of proof in NASD disciplinary proceedings is upon the NASD. *See Steadman v. SEC*, 450 U.S. 91, 95, 101 S.Ct. 999, 1004, 67 L.Ed.2d 69 (1981). The proper standard to be applied is the preponderance of the

evidence standard. *Seaton v. SEC*, 670 F.2d 309, 311 (D.C. Cir. 1982), *citing Steadman v. SEC*.

Thus, the burden was upon the NASD to show by a preponderance of the evidence that Stoiber violated the NASD's rules because the particular notes at issue **were** "securities" under *Reves*, and not upon Stoiber to demonstrate that the notes **were not** "securities".

The burden of proof remains on the NASD notwithstanding that under *Reves*, "[a] note is presumed to be a 'security'". In federal civil proceedings "a presumption imposes on the party against whom it is directed the burden of going forward with evidence to rebut or meet the presumption, but does not shift to such party the burden of proof in the sense of the risk of nonpersuasion, which remains throughout the trial upon the party on whom it was originally cast." 12 Fed. Proc. L.Ed. § 33:91, p. 116 (1988).

This view of presumptions is the so-called "bursting bubble" theory, under which a presumption vanishes from a case upon the introduction of contrary evidence. *Legille v. Dann*, 544 F.2d 1, 5-6 (D.C. Cir. 1976). Once such antithetical evidence is introduced, the presumption does not linger to be weighed against other evidence, does not enjoy the status of evidence, and has no probative effect. 12 Fed. Proc. L.Ed. § 33:94, p. 121 (1988). It is only where an Act of Congress itself expressly creates the presumption and also provides for a different effect that a different effect is to be given. 12 Fed. Proc. L.Ed. §33:92, pp. 118-19 (1988). Thus, the "bursting bubble" theory of presumptions should be deemed applicable to the presumption created by the Supreme Court in *Reves*.

The Court of Appeals rejected such an application of the *Reves* presumption, stating that the presumption is rebutted only when the maker of the notes can show that the note should not be considered a "security" under the two-step, four-factor analysis set forth in *Reves*. In effect, the Court of Appeals converted the *Reves* presumption into an affirmative defense. Such a decision conflicts with this Court's intention in fashioning the presumption in *Reves*. This Court has demonstrated repeatedly that it knows the difference between a presumption and an affirmative defense, and that it will use the phrase "affirmative defense" when that is what it intends to create. *E.g. Faragher v. City of Boca Raton*, 118 S.Ct. 2275, 2293 (1998)(in a hostile environment sexual harassment case, "a defending employer may raise an affirmative defense to liability or damages, subject to proof by a preponderance of the evidence"). If this Court had intended the *Reves* presumption to have the effect of an affirmative defense, then it would have used that terminology.

This Court's use of the term "presumption" instead of "affirmative defense" suggests that it intended the *Reves* test to embody the same kind of "bursting bubble" presumption it recognized in *Basic Inc. v. Levinson*, 485 U.S. 224, 245, 108 S.Ct. 978, 991, 99 L.Ed.2d 194 (1988)(citing FRE 301); *Kaplan v. Rose*, 49 F.3d 1363, 1376 (9th Cir. 1994)(citing FRE 301). There is little sense in the notion that the *Basic, Inc.* presumption is a "bursting bubble" presumption, but that the *Reves* presumption is in reality an affirmative defense. Both presumptions arise under the Securities Exchange Act and both were created by this Court rather than by express statutory language. The Court of Appeals failed to address this glaring contradiction head-on, dealing with Stoiber's argument only in a cursory footnote.

Upon reviewing the SEC Decision (Appendix II), it is apparent the SEC failed to apply the "bursting bubble" theory of presumptions, a point the SEC essentially admitted in its brief to the Court of Appeals. The SEC therefore improperly reversed the burden of proof in this case, in effect, requiring Stoiber to prove that the notes were not "securities".

The SEC's rejection of the "bursting bubble theory" (and consequent burden-shifting) becomes explicit at page 10 of its Decision (Appendix II) where it states:

> Based on our consideration of the factors cited in *Reves*, Stoiber has not presented sufficient evidence to rebut the presumption that the notes at issue are securities.

This conclusion is incorrect as a matter of law because all that is required to rebut the presumption is that the party present some substantial evidence antithetical to it. *Legille v. Dann*, 544 F.2d 1, 5-6 (D.C. Cir. 1976), *citing New York Life Ins. Co. v. Gamer*, 303 U.S. 161, 170, 171, 58 S.Ct. 500, 503, 82 L.Ed.2d 726, 730, 731 (1938) *and Stone v. Stone*, 136 F.2d 761, 763 (D.C. Cir. 1943).

Stoiber presented far more evidence than necessary to rebut the *Reves* presumption. (In fact, virtually all the evidence in the case supports the conclusion that the notes were not "securities".) It is only where the party opposing the presumption fails to produce **any** rebuttal evidence that the presumption lingers on. *E.g., U.S. v. Ahrens*, 530 F.2d 781, 786-87 (8th Cir. 1976).

The failure of the SEC and the Court of Appeals to treat the *Reves* presumption as a true presumption rather than as an affirmative defense is contrary to the intention of this Court in fashioning the *Reves* test. Moreover, this erroneous treatment of the *Reves* presumption is inconsistent with longstanding principles established in securities cases and non-securities cases alike.

II. THE AFFIRMANCE OF THE SEC'S SANCTIONS CONFLICTS WITH THE EIGHTH AMENDMENT TO THE UNITED STATES CONSTITUTION AS INTERPRETED BY THIS COURT IN *U.S. v. BAJAKAJIAN*, 524 U.S. 321 (1998).

The Eighth Amendment to the United States Constitution provides: "Excessive bail shall not be required, nor excessive fines imposed, nor cruel and unusual punishments inflicted." U.S. Const., Amdt. 8. The SEC's imposition of a $450,000 fine against Stoiber is so grossly disproportionate to the misconduct he was found to have committed that it violates his constitutional rights under the Eighth Amendment.

Last term, this Court in *U.S. v. Bajakajian*, 524 U.S. 321, applied the Eighth Amendment to a forfeiture imposed in a criminal case. The Court should use this case as the opportunity to define how the Eighth Amendment applies to fines imposed in administrative disciplinary proceedings, a common, and increasing, occurrence in the securities field.

Here, as in *Bajakajian*, Stoiber's offense was solely a reporting offense and was unrelated to any other prohibited activities. There was no evidence of fraud, no

misrepresentation, and no losses by any customers. It was conceded by the SEC that it was not a violation of NASD rules for a broker to borrow money from a customer. It was only a violation if Stoiber did not obtain prior written approval of a security sale that landed him in hot water in the instant case.

Here, as in *Bajakajian*, the harm Stoiber caused by failing to obtain prior written consent of his firm was minimal. None of the lenders were injured and all of them signed reaffirmation agreements under the supervision of the State of Illinois. There was no loss to Stoiber's firm. Stoiber's conduct merely resulted in there being no written record of the firm's prior consent to the notes being issued. Comparing the gravity of Stoiber's violation with the $450,000 fine imposed, it appears beyond doubt that the fine is penal in nature and grossly disproportionate to the gravity of the offense. Accordingly, the fine is unconstitutional and should be overturned by this Court.

The Court of Appeals held that Stoiber's Eighth Amendment argument was waived. While it is true that the Eighth Amendment argument *per se* was never raised before the SEC, Stoiber's **objection** to the excessiveness of the fine imposed was raised and extensively briefed. That is all that 15 U.S.C. § 78y(c)(1) requires. Moreover, the failure to raise an issue in a prior forum is excusable when due to an intervening change in the law. *See Association of Bituminous Contractors, Inc. v. Apfel*, 156 F.3d 1246, 1254 n.5 (D.C. Cir. 1998); *Roosevelt v. E.I. Du Pont de Nemours & Co.*, 958 F.2d 416, 419 & n.5 (D.C. Cir. 1992). Stoiber's Eighth Amendment arguments were raised in light of the *Bajakajian* decision issued two weeks before Stoiber's brief to the Court

of Appeals was due. *Bajakajian* is a landmark decision that breathed new life into Eighth Amendment jurisprudence.

CONCLUSION

Petitioner respectfully, request that the Court grant his petition and reverse the judgment of the Court of Appeals and the Securities and Exchange Commission.

Respectfully submitted,

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(Any footnotes trail end of each document)

GERALD J. STOIBER, PETITIONER v. SECURITIES AND EXCHANGE COMMISSION, RESPONDENT

No. 98-1062

UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

November 9, 1998, Argued
December 8, 1998, Decided

COUNSEL: Thomas D. Birge argued the cause and filed the briefs for petitioner.

Randall W. Quinn, Assistant General Counsel, Securities and Exchange Commission, argued the cause for respondent. With him on the brief were Jacob H. Stillman, Associate General Counsel, and Paul Gonson, Solicitor. Susan K. Straus, Attorney, entered an appearance.

JUDGES: Before: WALD, WILLIAMS and HENDERSON, Circuit Judges. Opinion for the Court filed by Circuit Judge WALD.

OPINIONBY: WALD

OPINION:

WALD, Circuit Judge: Petitioner Gerald Stoiber is an Illinois broker associated with American Investment Services, Inc. ("AIS"). AIS is a member of the National Association of Securities Dealers, Inc. ("NASD"), a self-regulatory

organization in the securities field. Stoiber borrowed a total of $ 495,000 from his customers, gave the lenders promissory notes in exchange, and used most of the money to invest in commodities. The NASD filed disciplinary charges against him, asserting that he violated the NASD Rules of Fair Practice by selling securities (the notes) without giving AIS prior written notice. Stoiber was sanctioned by the NASD and appealed to the Securities and Exchange Commission ("SEC" or "Commission"), which affirmed the sanctions. See In re Gerald James Stoiber, 65 S.E.C. Docket 1097 (1997). The SEC denied a request for reconsideration. See In re Gerald James Stoiber, 66 S.E.C. Docket 731 (1998).

Stoiber petitions for review of the SEC's decision under 15 U.S.C. § 78y. He argues that the promissory notes are not securities, that the SEC misapplied the test articulated by the Supreme Court for determining whether a note is a security, that the Commission abused its discretion by approving the sanctions, and that the sanctions violate the Eighth Amendment's Excessive Fines Clause. We deny the petition for review because the SEC properly concluded that the notes are securities, the SEC did not abuse its discretion, and Stoiber waived the Excessive Fines argument by not raising it before the Commission.

I. BACKGROUND

From 1991 to 1993, Stoiber approached thirteen customers and asked to borrow various sums of money totaling $ 495,000. n1 He explained that most of the money would be used for financing commodities trading in his own trading account and the rest for personal uses. n2 Each customer gave him $ 10,000 to $ 200,000 and Stoiber executed unsecured promissory notes in return. The notes provided for terms of

two to five years n3 and fixed interest rates ranging from six to twelve percent. The record indicates that the interest rate on many of the notes was about two points over the prime rate at the time of execution. Stoiber also borrowed money from his parents but did not give them any promissory notes; that borrowing was not part of the disciplinary action.

Stoiber had known the note holders, on average, for over nine years when the notes were executed. He testified before the NASD that he has meaningful social relations with all of them beyond the usual broker-customer relationship. He explained, for example, that they sent his children gifts on their birthdays and one is like a mother to him.

The National Futures Association ("NFA") conducted a commodities review of AIS in 1993. The NFA examiner learned of the notes and informed the NASD and the state of Illinois. Both commenced investigations. The Illinois investigation led to an agreement with Stoiber that he would offer rescission to the note holders; every note holder declined the offer.

On April 6, 1994, the NASD charged Stoiber with violations of Sections 1 and 40 of Article III of the NASD Rules of Fair Practice (since renamed Rules 2110 and 3040). Section 1 requires that "[a] member, in the conduct of his business, shall observe high standards of commercial honor and just and equitable principles of trade." Section 40 is the focus of the allegations against Stoiber. It provides, in relevant part:

> (a) Applicability--No person associated with a member shall participate in any manner in a private securities transaction except in

> accordance with the requirements of this section.
>
> (b) Written Notice--Prior to participating in any private securities transaction, an associated person shall provide written notice to the member with which he is associated describing in detail the proposed transaction and the person's proposed role therein and stating whether he has received or may receive selling compensation in connection with the transaction; provided however that, in the case of a series of related transactions in which no selling compensation has been or will be received, an associated person may provide a single written notice.

The NASD asserted that the promissory notes are securities, a prerequisite to the applicability of Section 40, and that Stoiber sold them without giving AIS prior written notice. n4

A hearing was held before the NASD District Business Conduct Committee for District No. 8 which found that Stoiber had violated Sections 1 and 40. On appeal, the NASD National Business Conduct Committee agreed. The National Committee censured Stoiber, suspended him for six months, required $ 450,000 in restitution (the amount borrowed that was still outstanding), assessed costs totaling $ 1,299.25, and imposed a $ 450,000 fine, but allowed the fine to be reduced by the amount of restitution paid within sixty days. Stoiber appealed to the SEC which affirmed the NASD and subsequently denied a request for reconsideration. n5

II. DISCUSSION

A. Whether the Promissory Notes are Securities

Stoiber argues that the Commission erred in determining that the promissory notes he executed in return for the funds provided by his customers are properly classified as securities. If the notes are not securities, he could not be held to have violated Section 40.

The definition of "security" in section 3(a)(10) of the Securities Exchange Act of 1934, the source of the SEC's authority in this matter, includes a long list of financial instruments, beginning with "any note." n6 Although courts initially interpreted "any note" literally, see Harold S. Bloomenthal & Holme Roberts & Owen, Securities Law Handbook § 2.04[2], at 42 (1998 ed.), an inquiry into whether a particular note is a security has become much more demanding under the test articulated by the Supreme Court in Reves v. Ernst & Young, 494 U.S. 56, 108 L. Ed. 2d 47, 110 S. Ct. 945 (1990). The Court stated there that "the phrase 'any note' should not be interpreted to mean literally 'any note,' but must be understood against the backdrop of what Congress was attempting to accomplish in enacting the Securities Acts." Id. at 63. Congress' purpose "was to regulate investments, in whatever form they are made and by whatever name they are called." Id. at 61 (emphasis in original).

Under the Reves "family resemblance" test, every note is first presumed to be a security but the presumption may fall away under either step of a two-tiered analysis. See id. at 67. In the first step the notes under review are compared to several

types of notes that the Court specifically said are not securities. Those are

> the note delivered in consumer financing, the note secured by a mortgage on a home, the short-term note secured by a lien on a small business or some of its assets, the note evidencing a 'character' loan to a bank customer, short-term notes secured by an assignment of accounts receivable, [ ] a note which simply formalizes an open-account debt incurred in the ordinary course of business (particularly if, as in the case of the customer of a broker, it is collateralized)[, and] ... notes evidencing loans by commercial banks for current operations.

Id. at 65 (quotation marks and citation omitted). The comparison between the note in question and the excluded notes is to be made by considering four factors: (1) "the motivations that would prompt a reasonable seller and buyer to enter into [the transaction]," (2) "the 'plan of distribution' [*10] of the instrument," (3) "the reasonable expectations of the investing public," and (4) "whether some factor such as the existence of another regulatory scheme significantly reduces the risk of the instrument, thereby rendering application of the Securities Acts unnecessary." Id. at 66-67. The note is not a security if this four-factor comparison reveals a "strong resemblance" to one of the enumerated types of notes. Id. at 67. If a strong resemblance is not found, the court invokes the second step of the analysis--"the decision whether another category should be added...." Id. This decision "is to be made by examining the same [four] factors." Id. Whether a note is a security is a question of law, so the court applies this test de novo. See SEC v. Life Partners, Inc.,

318 U.S. App. D.C. 320, 87 F.3d 536, 541 (D.C.Cir. 1996).
n7
1. The First Reves Factor--Motivation

Reves explains the first factor as follows:

> First, we examine the transaction to assess the motivations that would prompt a reasonable seller and buyer to enter into it. If the seller's purpose is to raise money for the general use of a business enterprise or to finance substantial investments and the buyer is interested primarily in the profit the note is expected to generate, the instrument is likely to be a "security." If the note is exchanged to facilitate the purchase and sale of a minor asset or consumer good, to correct for the seller's cash-flow difficulties, or to advance some other commercial or consumer purpose, on the other hand, the note is less sensibly described as a "security."

Reves, 494 U.S. at 66.

We have little trouble concluding that Stoiber's main purpose for using the notes points in the direction of their being securities. All but $ 50,000 of the $ 495,000 raised from his customers was used for commodities trading in his personal account. Moreover, in reaffirmation statements signed when they declined Stoiber's rescission offers, the customers acknowledged that they knew at the time of the transactions that most of the money would be used for such trading. We think trading in commodities clearly falls under the "financing substantial investments" language in Reves.

Stoiber predictably disagrees. He argues that he was in the business of selling commodities and that he used the money to purchase inventory which he then attempted to resell at a profit. This he terms a commercial, not an investment purpose. Stoiber's regular business, however, was buying and selling on behalf of his customers; his earnings came not from the difference between the purchase and sale prices of the securities he traded but from commissions. Stoiber's trading in commodities was not part of his brokerage business, and so we cannot say that the commodities trading had a commercial purpose related to that business.

But even if we accept the proposition that personal commodities trading was a new business Stoiber planned to operate distinct from his usual brokerage business, use of the note money to buy an inventory of commodities is more akin to "raising money for the general use of a business enterprise" than the specific commercial uses cited in Reves such as remedying a cash flow deficit or purchasing a specific asset. Although the line between commercial and investment uses may not always be sharp, Reves' examples appear to distinguish between funding the enterprise generally and funding a discrete component or department of the enterprise. Because the purchase of commodities for reselling was at the core of Stoiber's "business" of trading in them, his use of the money to buy them is appropriately viewed as a general business use.

We also perceive that Stoiber's customers were primarily motivated by the opportunity to earn a profit on their money. The NASD's investigator interviewed the note holders and testified that "the customers were providing the money because they knew Mr. Stoiber fairly well and trusted him and

were interested in receiving a competitive interest rate." Transcript at 32 (emphasis added). The rates they received--two points over prime--were described by the SEC, possessed of greater expertise than we, as "favorable." In re Gerald James Stoiber, 65 S.E.C. Docket at 1100. And the Supreme Court has said a favorable interest rate indicates that profit was the primary goal of the lender. See Reves, 494 U.S. at 67-68 (variable rate designed to stay above rate offered by local financial institutions). The fact that the rates were fixed and not variable does not suggest otherwise. See Pollack v. Laidlaw Holdings, Inc., 27 F.3d 808, 813 (2d Cir. 1994) (noting that fixed rate bonds are regulated as securities).

Stoiber argues that the customers provided funds because of the personal relationships he had with them. His evidence includes affidavits submitted by the note holders, which state that "I believe Mr. Stoiber is an honest and successful business person, and I believe him to be a good risk to repay me the loan; that is the reason why I loaned him this money." This display of trust, however, does not speak to the note holders' original motivations in making the loans. Rather, it speaks to the information available to them when deciding whether the notes involved a tolerable level of risk. The only evidence in the record that sheds light on the customers' motivations indicates that profit in the form of interest was their primary goal.

There is also a substantial difference between the goals of the parties in this case and those involved when banks provide character loans or commercial loans for current operations--two types of lending evidenced by notes that are not considered securities under Reves, and which Stoiber argues bear a "family resemblance" to his notes. Character loans are generally offered in an attempt to cement or

maintain an ongoing commercial relationship with the borrower. A loan for current operations allows the borrower to achieve the commercial goal of continuing to operate a business smoothly during a period when cash inflows and outflows do not match up. These purposes do not characterize the notes here. Unlike with a character loan, the note holders were not trying to satisfy a potential or actual customer. Unlike with a loan for current operations, Stoiber was funding his entire endeavor, not just getting past a cash crunch.

2. The Second Reves Factor--Plan of Distribution

Under the second Reves factor, we examine the plan of distribution of a note "to determine whether it is an instrument in which there is common trading for speculation or investment." Reves, 494 U.S. at 66 (citation and internal quotation marks omitted). "The requisite 'common trading' " is established if the instrument is "offered and sold to a broad segment of the public...." Id. at 68.

This factor points in no clear direction in this case. While the terms of the notes do not preclude trading in a secondary market, none have been resold and there is no indication that anyone has considered reselling them. Nor do we think thirteen customers with whom Stoiber had a personal relationship constitute "a broad segment of the public."

On the other hand, Stoiber solicited individuals, not sophisticated institutions. While his solicitations included individual presentations, he offered his customers little detail. These facts suggest common trading. See RTC v. Stone, 998 F.2d 1534, 1539 (10th Cir. 1993); Banco Espanol de Credito v. Security Pac. Nat'l Bank, 973 F.2d 51, 55 (2d Cir. 1992).

3. The Third Reves Factor--Expectations

The Supreme Court described the third factor as follows:

> Third, we examine the reasonable expectations of the investing public: The Court will consider instruments to be "securities" on the basis of such public expectations, even where an economic analysis of the circumstances of the particular transaction might suggest that the instruments are not "securities" as used in that transaction.

Reves, 494 U.S. at 66.

Whether notes are reasonably perceived as securities generally turns on whether they are reasonably viewed by purchasers as investments. See id. at 68-69; Pollack, 27 F.3d at 814; SEC v. R.G. Reynolds Enters., Inc., 952 F.2d 1125, 1131 (9th Cir. 1991). When a note seller calis a note an investment, in the absence of contrary indications "it would be reasonable for a prospective purchaser to take the [offeror] at its word." Reves, 494 U.S. at 69. See also R.G. Reynolds Enters., Inc., 952 F.2d at 1131. Conversely, when note purchasers are expressly put on notice that a note is not an investment, it is usually reasonable to conclude that the "investing public" would not expect the notes to be securities. See Banco Espanol de Credito, 973 F.2d at 55-56. Here, there is no indication that Stoiber called the notes investments. Although of questionable value due to their conclusory character, affidavits submitted by the customers stated that the notes were not considered to be investments. The limited evidence

thus suggests that Stoiber's investing public did not reasonably view the notes as securities.

This admission does not, however, add much to the inquiry into whether the promissory notes are securities. The Supreme Court itself described this factor as a one-way ratchet. See Reves, 494 U.S. at 66. It allows notes that would not be deemed securities under a balancing of the other three factors nonetheless to be treated as securities if the public has been led to believe they are. It does not, however, allow notes which under the other factors would be deemed securities to escape the reach of regulatory laws. In this case, then, the third Reves factor is basically a wash.

4. The Fourth Reves Factor--Need for Federal Securities Laws

The fourth and final inquiry looks to the adequacy of regulatory schemes other than the federal Securities Acts in reducing risk to the lender. Reves indicates that an alternative regulatory scheme, collateral, and insurance are all capable of reducing the risk to note holders sufficiently to render the protection of federal securities laws unnecessary. See id. at 69; see also Stone, 998 F.2d at 1539 (collateral).

Stoiber argues that "the circumstances of the loans and the creditor/debtor laws of the State of Illinois already provide adequate protection to the lenders." The circumstances he refers to are provisions in the notes for acceleration of payment upon default and recovery of collection costs and attorney fees. We think these are significantly less valuable than collateral or insurance and not by our thinking an adequate substitute for the protection of federal law. Unlike the securities laws, they do not provide any oversight over the initiation of the transactions or Stoiber's handling of the funds.

Indeed, part of why the SEC believes that Stoiber's failure to provide his firm notice of the note transactions represents a serious omission is that it denied the note holders the value of oversight by the firm as to how he used the money and whether he fulfilled the note obligations. Unlike collateral and insurance, acceleration provisions and the like in the notes do not guarantee recovery by the note holders if Stoiber loses everything in his commodities investments or defaults for some other reason.

As for protection afforded by Illinois laws, Stoiber's reliance on them would expand the types of alternative protection cognizable beyond those contemplated in Reves. n8 The risk reducing factors described by the Reves Court operate to prevent investors from harm in the first place or, like insurance and collateral, make recovery more likely after injury. In explaining the fourth factor, the Court looked to Marine Bank v. Weaver, 455 U.S. 551, 557-58, 71 L. Ed. 2d 409, 102 S. Ct. 1220 (1982), which involved certificates of deposit that were insured by the FDIC and the subject of substantial federal banking regulations. See Reves, 494 U.S. at 67, 69. Similarly, the Second Circuit found an alternative regulatory scheme sufficient when the sale of the notes at issue was governed by guidelines of the Comptroller of the Currency. See Banco Espanol de Credito, 973 F.2d at 55-56. The provisions of Illinois law relied on by Stoiber are of a different type; he asserts basically only that state courts are open and that injured note holders can bring lawsuits. Like his "circumstances of the loans," however, this opportunity only operates post-injury and offers much less certainty than collateral and insurance. We do not think Illinois law renders the protection of federal securities law unnecessary in this case. n9

Comparing Stoiber's notes to character and commercial loans offered by banks also suggests that the protection of federal securities law is not redundant here. We agree with the SEC that bank loans and Stoiber's notes are very different; a bank has the expertise and the access to records needed to carefully assess a person's creditworthiness and financial plans. Stoiber's customers had no such expertise or access. While the long-lasting relationships between Stoiber and his customers did give the note holders personal information about their solicitor not always available to bankers, we do not think this can be an adequate substitute for the objective data and analytical skills possessed by lending institutions. Information and evaluation of friends based on personal relationships is often subject to manipulation and skewed by other facets of the relationships.

5. The Reves Factors Viewed Collectively

Based on the four Reves factors, then, we conclude that the promissory notes executed by Stoiber are securities. They do not bear a strong enough resemblance to the categories of notes declared by the Supreme Court to be outside the definition of securities and the four factors do not suggest that these notes should be treated as a new non-security category. Admittedly the plan of distribution in part signals that the notes might not be securities, but that factor by itself is not dispositive. See Trust Co. of Louisiana v. NNP Inc., 104 F.3d 1478, 1489 (5th Cir. 1997) ("A debt instrument may be distributed to but one investor, yet still be a security."). The motivations of Stoiber and his customers and the lack of sufficient risk reducing factors other than federal securities laws strongly favor treating the notes as securities, despite the close plan of distribution. The remaining factor--the

reasonable expectations of the investing public--is not relevant in this case.

B. Whether the SEC Erred in Affirming the NASD's Sanctions

Having determined that the notes are securities to which NASD's Section 40 applied, we consider the appropriateness of the sanctions. Stoiber objects to the suspension, the restitution requirement, and the fine. We review an SEC decision affirming sanctions imposed by the NASD against a broker for an abuse of discretion. See Svalberg v. SEC, 277 U.S. App. D.C. 422, 876 F.2d 181, 184 (D.C. Cir. 1989) (per curiam); Seaton v. SEC, 216 U.S. App. D.C. 151, 670 F.2d 309, 311 (D.C. Cir. 1982) (per curiam).

In affirming Stoiber's sanctions, the SEC explained that they fell within the NASD's recommended range for serious conduct that deprived public investors of protection and improperly exposed Stoiber's employer to risk. We note that the SEC has indeed treated this kind of violation seriously on numerous prior occasions. See, e.g., In re Gilbert M. Hair & Vladimir Chorny, 51 S.E.C. 374, 378 & n.10 (1993). Stoiber nonetheless counters with numerous reasons why he should have been accorded less severe sanctions, i.e., whether the notes are securities is a close call, he did not act willfully, he did not try to conceal the notes, he gave his firm oral notice of the loans, the customers were not injured, the customers and his firm did not seek disciplinary action, he has a spotless disciplinary record, and the customers declined rescission.

In Seaton, this court affirmed a one year suspension in a similar situation. The broker there sold securities to customers three times without his employer's knowledge and also

answered questions falsely on an application to work with another firm. See Seaton, 670 F.2d at 310. At that time the NASD Rules of Fair Practice did not include Section 40, but Section 1 had been interpreted to include the written notification requirement for brokers participating in private securities transactions. See id.; In re William Louis Morgan, 51 S.E.C. 622, 625 n.12 (1993). The case did not involve fraud or harm to any investors. See Seaton, 670 F.2d at 311. We stated that:

> We will not lightly disturb the findings of an agency in its area of expertise. In this case there is an undisputed pattern of repeated violations, the significance of which the Commission is better equipped to judge than this Court. There is no indication that the Commission has abused its discretion in affirming the sanctions.

Id. In another similar case, the SEC described violations as willful and entered permanent suspensions, even though the brokers involved apparently acted on advice of counsel. See O'Leary v. SEC, 137 U.S. App. D.C. 420, 424 F.2d 908, 909, 912 (D.C. Cir. 1970). The brokers were evidently first offenders and investors did not suffer any injury. See 424 F.2d at 912. We upheld the suspensions, noting that while the mitigating factors " 'might have warranted a lighter sanction, they did not require one.' " Id. (quoting Tager v. SEC, 344 F.2d 5, 8 (2d Cir. 1965)). Additionally, the NASD Sanction Guidelines call for consideration of a suspension of up to two years or, in egregious cases, a permanent bar. See NASD Regulation, Inc., NASD Sanction Guidelines 15 (1998) ("Guidelines"). In light of Seaton, O'Leary, and the

Guidelines, we cannot say that the six month suspension of Stoiber was an abuse of discretion.

Stoiber contends that the restitution requirement is unjustifiable in light of the uniformly rejected rescission offers he made under his agreement with the state of Illinois. The SEC's concerns are not identical to those of Illinois, however, and Illinois never found Stoiber in violation of state laws or regulations, whereas the SEC found violations of the NASD Rules. A stiffer response from the SEC is thus not surprising. As the notes were at the core of Stoiber's violations, it was not an abuse of discretion for the SEC to require Stoiber to disgorge what he had obtained improperly. See Hateley v. SEC, 8 F.3d 653, 656-57 (9th Cir. 1993) (ordering disgorgement in amount equal to ill-gotten gain); see also Guidelines at 7 n.2 ("restitution is an appropriate method of depriving a respondent of his or her ill-gotten gain").

The SEC makes a convincing case that the size of the fine, $ 450,000 less restitution made within sixty days, is appropriate under the NASD Guidelines. The Guidelines call for a fine of $ 5,000 to $ 50,000 for violation of the written notification requirement. The SEC correctly asserts that it is entitled to treat Stoiber's actions as thirteen separate violations, one for each note. See Svalberg, 876 F.2d at 185. At a maximum $ 50,000 per violation, the ceiling goes up to $ 650,000. n10 The SEC also argues that the Guidelines allow the fine to be increased by the amount of money received from the note holders. While the Guidelines do allow adjudicators to "add[ ] the amount of a respondent's financial benefit," Guidelines at 15 n.2, the benefit to Stoiber here was only the temporary use of the money, not the amount of the notes in full. The SEC does not need this extra fillip since the $ 5,000 to $ 50,000 Guidelines range for each violation is sufficient to

demonstrate that the fine was not excessive. We also note that three of the four "principal considerations" listed in the Guidelines with respect to this kind of violation militate in favor of a severe fine: Stoiber was affiliated with the issuer (he was the issuer), he sold the notes to customers of the firm, and he did not provide the firm with "verbal notice of all relevant factors." n11 Guidelines at 15. Additionally, although Stoiber argues that the note holders have not suffered any injury, the Guidelines state that "adjudicators should not consider whether the investment or enterprise was successful." Id. at 15 n.1. We conclude then that the SEC did not abuse its discretion in affirming the fine imposed by the NASD.

C. Whether the Fine Violates the Eighth Amendment

Stoiber also argues that the fine violates the Eighth Amendment's Excessive Fines Clause n12 because it is not proportional to his misconduct. We consider this argument waived because Stoiber failed to raise it before the SEC as required by statute:

No objection to an order or rule of the Commission, for which review is sought under this section, may be considered by the court unless it was urged before the Commission or there was reasonable ground for failure to do so.

15 U.S.C. § 78y(c)(1). This requirement is not inapplicable solely because the objection not urged before the SEC is a constitutional one. See C.E. Carlson, Inc. v. SEC, 859 F.2d 1429, 1439 (10th Cir. 1988).

The failure to raise an issue in a prior forum is excusable when due to an intervening change in the law, see Association of

Bituminous Contractors, Inc. v. Apfel, 156 F.3d 1246, 1254 n.5 (D.C. Cir. 1998); Roosevelt v. E.I. Du Pont de Nemours & Co., 294 U.S. App. D.C. 198, 958 F.2d 416, 419 & n.5 (D.C. Cir. 1992), but no such exception is applicable here. Stoiber contends that United States v. Bajakajian, 141 L. Ed. 2d 314, 118 S. Ct. 2028 (1998), decided after the SEC affirmed the NASD in his case, "is a landmark decision that breathed new life into Eighth Amendment jurisprudence." Although Bajakajian did reject a fine because of a lack of proportionality with the offense, it certainly was not the source of any new or novel proportionality requirement. See Pharaon v. Board of Governors of Fed. Reserve Sys., 328 U.S. App. D.C. 349, 135 F.3d 148, 156 (D.C. Cir.), cert. denied, 119 S. Ct. 371 (1998) (stating, months before Bajakajian was decided, that the "Clause requires us to consider the value of the fine in relation to the offense"). Bajakajian did not elevate Stoiber's Excessive Fines claim "from completely untenable to plausible." United States v. Byers, 239 U.S. App. D.C. 1, 740 F.2d 1104, 1116 n.11 (D.C. Cir. 1984) (en banc). Stoiber's objection to the fine on other grounds before the agency was not sufficient to avert waiver on this one.

III. CONCLUSION

Because the SEC correctly determined that the promissory notes are securities, the sanctions do not constitute an abuse of discretion, and Stoiber waived his Eighth Amendment claim, the petition for review is denied.

So ordered.

Footnotes

n1 The proper initial date is ambiguous in the NASD's complaint. It first describes the period in question as March 1, 1992 to September 23, 1993. Eleven notes were executed during that period. The complaint, however, also includes a chart listing thirteen notes executed between March 1, 1991 and September 23, 1993. The record contains numerous indications from both parties that thirteen notes are under review.

n2 Stoiber estimated that he spent $ 50,000 on personal expenses (a $ 20,000 payment toward his mortgage and the rest for credit card and hospital bills).

n3 Some were subsequently extended.

n4 The lack of written notice is not disputed. Stoiber claims, however, that he gave oral notice to James Burgauer, the AIS director of compliance and part owner of the firm. Both Stoiber and Burgauer agreed that, before the first note transaction, Stoiber asked Burgauer about how he should document any borrowing, and Burgauer gave him a copy of a promissory note he had on file. Stoiber claims that he told Burgauer that he might ask customers for money, but Burgauer did not remember this aspect of the conversation.

n5 The SEC did not address whether, if the notes are not securities, Stoiber had nonetheless violated Section 1, a conclusion the NASD National Committee reached with little explanation. The SEC addressed the Section 1 charge only in terms of the Section 40 charge, stating that violation of the latter established violation of the former, a link that petitioner does not contest. See In re Gerald James Stoiber, 65 S.E.C. Docket at 1101 n.22.

n6 The term is defined as

> any note, stock, treasury stock, bond, debenture, certificate of interest or participation in any profit-sharing agreement or in any oil, gas, or other mineral royalty or lease, any collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit, for a security, any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or in general, any instrument commonly known as a "security"; or any certificate of interest or participation in, temporary or interim certificate for, receipt for, or warrant or right to subscribe to or purchase, any of the foregoing; but shall not include currency or any note, draft, bill of exchange, or banker's acceptance which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited.

15 U.S.C. § 78c(a)(10). None of the notes here fall under the short term exception.

n7 At the outset we reject Stoiber's claim concerning the effect of the initial presumption in Reves that a note is a

security. He asserts that the mere introduction of some evidence suggesting that a note is not a security is enough to rebut the presumption. The Supreme Court, however, stated that the "presumption may be rebutted only by a showing that the note bears a strong resemblance ... to one of the enumerated categories of instrument.... [or that] another category should be added...." Reves, 494 U.S. at 67. Thus, the presumption is only rebutted when the two-step, four-factor analysis based on all the evidence leads to the conclusion that a note is a not a security.

n8 Stoiber explains that the state statute of limitations is longer, that punitive damages are available, and that unlike under federal securities law plaintiffs can sometimes succeed under the Illinois Consumer Fraud Act without demonstrating scienter. See Petitioner's Brief at 32. He also explains that the venue and process service provisions of federal law are unnecessary because all of the note holders are Illinois residents and that the federal securities law controlling person liability provisions are unnecessary because Stoiber provided the notes in his individual capacity. See id. at 31.

n9 We therefore need not reach the open question of whether state law can ever be an adequate substitute under the fourth Reves factor. See Pollack, 27 F.3d at 815. This question stems from the statement in Reves that "the notes here would escape federal regulations entirely if the [Securities] Acts were held not to apply." Reves, 494 U.S. at 69 (emphasis added).

n10 Even if we considered only the eleven violations that occurred within the time frame initially listed in the complaint, see supra note 1, the ceiling would still be greater than the fine imposed.

n11 The SEC observed that Stoiber only "spoke [with the compliance director] generically about obtaining loans." In re Gerald James Stoiber, 65 S.E.C. Docket at 1101 n.23.

n12 "Excessive bail shall not be required, nor excessive fines imposed, nor cruel and unusual punishments inflicted."

In the Matter of the Application of GERALD JAMES STOIBER 19140 Kristine Trail Mokena, Illinois 60448; For Review of Disciplinary Action Taken by the NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

Admin. Proc. File No. 3-8992

SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934 Release No. 39112

September 22, 1997

COUNSEL:

Jerome H. Ferguson, III, of Ferguson & Company, P.C., for Gerald James Stoiber.

Alden S. Adkins and Norman Sue, Jr., for NASD Regulation, Inc.

TEXT: OPINION OF THE COMMISSION

REGISTERED SECURITIES ASSOCIATION -- REVIEW OF DISCIPLINARY PROCEEDINGS

Violation of Rules of Fair Practice

Failure to Inform Employer of Private Securities Transactions

General securities representative associated with member firm of registered securities association engaged in private securities transactions without prior written notification to member. Held, association's findings of violation and the sanctions it imposed are sustained.

Appeal filed: April 26, 1996

Last brief received: August 1, 1996

I.

Gerald James Stoiber ("Applicant"), both a registered general securities representative and an associated person of a futures commission merchant associated with American Investment Services, Inc. ("AIS" or the "Firm"), a member of the National Association of Securities Dealers, Inc. ("NASD"), appeals from NASD disciplinary action. The NASD found that, during the period from March 1, 1992 through at least September 23, 1993, Stoiber sold securities in the form of promissory notes to thirteen public customers [*2] without giving AIS prior written notification and receiving written approval from AIS to engage in private securities transactions, in violation of Article III, Sections 1 and 40 of the Rules of Fair Practice ("Rules"). n1 The NASD censured Applicant, suspended him in all capacities for six months, ordered restitution to identified customers of $ 450,000, and fined him $ 450,000 to be reduced by any amounts paid in restitution within 60 days of the date of the decision. n2 Our findings are based on an independent review of the record.

II.

Stoiber does not deny that, between March 1992 and September 1993, he borrowed a total of $ 495,000 from his customers. n3 Stoiber issued promissory notes to the customers for these unsecured personal loans. n4 The notes at issue had fixed rates of interest, ranging from 6% to 12% per year. According to the NASD, the interest rate on the notes was generally set at 2% above the then-current prime rate. Interest was paid in fixed installments and payment of the principal was due on or before a specific date, in most instances three years from the date of issuance. On several occasions, Stoiber refinanced and "rolled-over" notes that he issued to his customers.

Stoiber had known many of these customers for years and stated that he considered them to be friends. The customers who loaned money to Stoiber had annual incomes that ranged from $ 10,000 to $ 75,000, and net worths that varied from a low of $ 50,000 to a high of $ 1,000,000.

Stoiber admits that he asked each of these customers to loan him funds to finance commodity transactions that he could not have effected absent the loan. Stoiber informed each of the customers that the proceeds from the notes were to be used to effect commodity transactions in Stoiber's personal account at AIS, as well as for personal expenses. n5

Stoiber placed the funds that he received from these notes in his personal bank account, which was held jointly with his wife. The funds were generally transferred from his personal bank account to Stoiber's commodities trading account. Stoiber maintained two other bank accounts in the name of an entity that he created and named Jeffrey Investment Services ("JIS"). Interest payments on the notes were made to each customer from the JIS accounts.

Stoiber's income was derived from his commissions from AIS and any profits resulting from his commodity trading. Although each of the customers stated in an affidavit that he or she thought that Stoiber was a successful businessman, Stoiber acknowledged that, at the time of the hearing before the NASD's District Committee, he had a negative net worth of approximately $ 30,000. Stoiber also acknowledged that he would be insolvent if all of the customers sought repayment of their funds at once. He claimed, however, that he could obtain the funds to repay the notes, if necessary, from his parents or by liquidating family assets. n6

III.

Article III, Section 40 prohibits an associated person of a member firm from effecting private transactions in securities without prior written notice to that person's employer. Stoiber admits that he did not give AIS written notice of the transactions at issue. Stoiber, however, contends that he did not violate Article III, Section 40 because the promissory notes at issue were not securities.

In Reves v. Ernst & Young, 494 U.S. 56 (1990), the Supreme Court considered the issue of when a note is a security within the meaning of Section 3(a)(10) of the Securities Exchange Act of 1934. The Supreme Court adopted the "family resemblance" test for determining when a note is a security. n7 Under that test, a note is presumed to be a security unless (1) an examination of the note, based on four factors described by the Court, n8 reveals that the note bears a strong resemblance to certain types of notes recognized as being outside the investment market regulated under the securities laws n9 or, (2) based upon the same four factors, the note should be added to the list.

A. Family Resemblance to Recognized Non-Securities

The Supreme Court in Reves considered a note evidencing a character loan to a bank customer to be outside the investment market regulated under the securities laws. Applicant asserts that the notes at issue bear a strong resemblance to a note evidencing a character loan to a bank customer. n10

We do not see a family resemblance between the notes at issue and a note evidencing a character loan to a bank customer. Banks are in the business of making loans. Character loans, in particular, are generally given to longstanding, large depositors, whose credit situation is known to the financial institution. The lenders in this instance, Stoiber's customers, were not financial institutions or accustomed to assessing lending risks, nor did they make loans as part of a business.

Stoiber points to affidavits executed by each of his customers which state that the customer considered Stoiber a good businessman and a good risk. We note initially that each of these affidavits is identical and was prepared for the NASD hearing. n11 The uniformity of the customers' understandings was not tested by cross-examination. The affidavits, moreover, are silent as to why the customer concluded that Stoiber was a good credit risk. Stoiber does not claim that customers had access to the type of financial or business information that a bank would have concerning its customer. Nor does Stoiber or any of the affiants suggest that the affiants engaged in the type of credit analysis in which a bank would engage or that Stoiber provided them with the type of information that would have made that analysis possible. n12

B. The Reves Factors

We further conclude that the factors described in Reves do not suggest that these notes should be excluded from regulation under the securities laws. The Supreme Court stated in Reves that an instrument is presumed to be a security, "if the seller's purpose is to raise money for general use of a business enterprise or to finance substantial investments and the buyer is interested primarily in the profit the note is expected to generate . . . ." The Court contrasted such a note with a note used to facilitate "some other commercial or consumer purpose." n13 Here, Stoiber issued the notes to raise funds to finance commodity transactions, as well as for his personal expenses. The customers who loaned Stoiber funds received a favorable interest rate on the notes at issue. Interest has been recognized by the Supreme Court as constituting a valuable return on an investment. n14

Applicant, however, cites language in the customers' affidavits that states that each customer understood that he or she was making a personal loan to Stoiber and "did not intend to make an investment." The affidavits do not explain this assertion further, except to state that the customers did not believe that the notes were "the same as a share of stock or a publicly offered debt instrument." This statement is not inconsistent with these documents being a private offering of a security. In any event, we believe that the "motivations that would prompt a reasonable seller and buyer to enter into" these transactions strongly suggest that they are securities. n15 As discussed above, the customers, who were not in the business of making loans, looked to Stoiber for investment advice. Each customer affidavit states that the customer expected a "valuable return" from the notes, i.e., the customer was "to receive back my principal, plus interest as provided in the note." n16 Stoiber

admits that he solicited funds "to finance substantial investments," his commodity transactions, as well as his personal expenses. n17

We believe the other prongs of Reves are also satisfied. The customers here varied widely as to income and net worth. There is no showing that they were sophisticated or that they asked for information that would permit them to assess Stoiber's financial condition. In most instances, they were in their sixties. It appears, moreover, that Stoiber made the same general representations to each of the customers, and there is no suggestion that any of the customers negotiated individual terms. The sole significant common denominator among the customers is that each of the customers previously had dealt with Stoiber and AIS for investment purposes. Stoiber, their registered representative, offered favorable interest rates to these customers in exchange for funds to permit him to participate in commodities trading, funds that the customers could have placed in other investments. n18

Applicant asserts that thirteen notes are an insufficient number to be considered an offering to the general public. Citing the 1,600 notes issued in Reves, Applicant argues that thirteen is, as a matter of law, insufficient to constitute a public distribution. Applicant is mistaken. The number of notes is not the sole controlling factor in determining whether there has been a public distribution. Rather, the focus of inquiry should be on the need of the offerees for the protections afforded by the federal securities laws. n19

Applicant further asserts that the customers were his friends, not members of the general public and that he did not generally advertise the notes' availability. It is not unusual, however, for investors to have a social relationship with a

registered representative. The existence of a social relationship does not mean, however, that such an investor would not be entitled to the same protections that a stranger to the offeror would receive in an offering under the federal securities laws.

We are also unaware of any risk-reducing factors that would make application of the federal securities laws unnecessary. n20 Applicant contends that state law provides sufficient protection, but he does not cite a particular statute or provision of state law, other than to make a vague reference to remedies such as "debtor/creditor laws." Applicant also does not explain the protection state law provides nor does he argue that state law is as protective as the federal securities laws. In this instance, it would be reasonable for investors to expect that the protection of the federal securities laws applied.

Based on our consideration of the factors cited in Reves, Stoiber has not presented sufficient evidence to rebut the presumption that the notes at issue are securities. n21 We accordingly sustain the NASD's findings that Stoiber violated Article III, Sections 1 and 40 of the Rules. n22

IV.

Stoiber argues that the sanctions assessed by the NASD are excessive, oppressive, and a burden on interstate commerce. He also claims that the sanctions violate the NASD's 1993 Sanction Guidelines. Stoiber notes that he has been a registered representative for almost two decades and does not have any prior disciplinary history. n23

We are unable to conclude that the sanctions imposed by the NASD are excessive or oppressive. While the NASD's Guidelines are exactly that, guidelines, the sanctions that are assessed in this case clearly fall within the NASD's recommended sanctions for private securities transactions. n24

Stoiber's violations involve serious conduct. Stoiber's failure to inform his Firm in writing of these securities transactions and obtain approval could be potentially harmful. Public investors were deprived of the protection to which they are entitled to expect, and his employer was exposed to risks to which it should not be exposed. n25 Under all the circumstances, we are unable to conclude that the sanctions imposed by the NASD are excessive or oppressive.

An appropriate order will issue. n26

By the Commission (Chairman LEVITT and Commissioners WALLMAN and JOHNSON); Commissioner HUNT dissenting.

Commissioner HUNT, dissenting:

I am unable to determine on this record whether or not the instruments in question are securities, and therefore I dissent from the majority's opinion.

ORDER SUSTAINING DISCIPLINARY ACTION TAKEN BY REGISTERED SECURITIES ASSOCIATION

On the basis of the Commission's opinion issued this day, it is

ORDERED that the disciplinary action taken by the National Association of Securities Dealers, Inc. against Gerald James Stoiber, and the Association's assessment of costs, be, and they hereby are, sustained.

By the Commission.

Footnotes

n1 The NASD recently revised and renumbered its Rules of Practice. Section 1 of the Rules [new Rule 2110] requires the observance of "high standards of commercial honor and just and equitable principles of trade." Section 40 [new Rule 3040] provides, among other things, that, prior to participating in any securities transaction outside the regular course or scope of his or her employment, a person associated with a member firm must give that firm prior written notification. In addition, if the firm is notified that the associated person may receive selling compensation, it is required to issue written approval or disapproval.

n2 The NASD also assessed costs.

n3 The complaint alleges "beginning in or about March 1, 1992 and continuing until at least on or about September 23, 1993, Respondent Stoiber offered and sold . . . securities in the form of promissory notes . . . ." We note that two of the loans were offered outside the review period, one on September 25, 1991 and another on March 1, 1991. While these two loans were outstanding during the review period, it appears that they were repaid in full prior to the NASD's District Business Conduct Committee ("District Committee") hearing. A third loan apparently was repaid in full prior to the

NASD's District Committee hearing. Thus, it appears that the total balance of the loans outstanding at the time of the NASD's District Committee hearing was $ 450,000.

n4 Stoiber issued promissory notes as follows:

# of loans amount of each loan
1 $ 200,000
1 $ 50,000
2 $ 40,000
1 $ 30,000
4 $ 20,000
3 $ 15,000
1 $ 10,000

We note that two of the notes in the record were not signed by Stoiber. A note for a third transaction at issue was not included in the record. Stoiber, however, admits that "all loans were spelled out by promissory notes with specific interest rates and payment dates." The record also includes signed reaffirmation letters acknowledging, among others, two of these loans. Affidavits introduced by Stoiber and executed by each customer acknowledge that "for the loan, Mr. Stoiber signed and gave me a promissory note . . . ."
n5 Stoiber stated that he paid $ 20,000 towards the mortgage for his personal residence and a portion of the funds to pay off hospital bills and credit card debt. He estimated that he used a total of $ 50,000 of the proceeds from the notes for personal expenses.

n6 The State of Illinois Securities Division investigated Stoiber's note transactions and ordered Stoiber to make rescission offers to each of the customers. None of the

customers accepted the rescission offer. Instead, they executed a document reaffirming the notes.

n7 494 U.S. at 64-65, 67 citing Exchange National Bank of Chicago v. Touche Ross & Co., 544 F.2d 1126 (2d Cir. 1976), modified by, Chemical Bank v. Arthur Andersen & Co., 726 F.2d 930 (2d Cir.), cert. denied, 469 U.S. 884 (1984).

n8 Those four factors are: (1) the motivations that would prompt a reasonable borrower and lender to enter into the transaction; (2) the plan of distributing the notes; (3) the reasonable expectations of the investing public regarding whether the instruments were securities; and (4) the presence of any alternative scheme of regulation or other factor that significantly reduces the risk of the instrument so as to make regulation under the securities laws unnecessary. 494 U.S. at 66-67.

n9 Id. at 65. The Supreme Court believed that the following notes are not securities: the note delivered in consumer financing; the note secured by a mortgage on a home; the short-term note secured by a lien on a small business or some of its assets; the note evidencing a character loan to a bank customer; a short-term note secured by an assignment of accounts receivable; the note that simply formalizes an open-account debt incurred in the ordinary course of business; and the note evidencing a loan by a commercial bank for current operations.

n10 Stoiber submitted an affidavit from an assistant vice-president and loan officer at Southwest Financial Bank of Orland Park stating that the promissory notes used by Stoiber are typical of notes which would be used by banks to make

"character" or "signature" loans and that such note forms are typical of promissory notes in general. The fact that both a bank and Stoiber used the same note form does not end the analysis of whether Stoiber's note is a security. As the Supreme Court stated in Tcherepnin v. Knight, 389 U.S. 332, 335 (1967) (citing SEC v. W.J. Howey Co., 328 U.S. 293, 298 (1946)), "in searching for the meaning and scope of the word 'security' in the Act, form should be disregarded for substance and the emphasis should be on economic reality."

n11 Indeed, the affidavits underscore their lack of tailoring to a particular customer. None of the affidavits discusses the customer's financial or personal situation. In addition, each states that "in the event" the affiant either made more than one loan to Stoiber or agreed to refinance a particular loan "every one of the statements I am making . . . is true as to each loan and refinancing."

n12 Applicant also asserts that the notes at issue bear a family resemblance to notes evidencing loans by commercial banks for current operations. Applicant claims that the notes at issue are similar to the loan participations at issue in Banco Espanol de Credito v. Security Pacific National Bank, 973 F.2d 51 (2d Cir. 1992), cert. denied, 509 U.S. 903 (1993).

We disagree. Unlike the matter before us, the motivations of the various institutions in Banco Espanol de Credito were to promote commercial purposes. Only institutional and corporate entities were solicited by the bank, and the loan participations could not be resold. In addition, the Court found that the institutions, who were found to be "sophisticated purchasers," were given ample notice that the instruments were participations in loans, not investments, and that the Comptroller of the Currency issued specific policy

guidelines addressing the sale of loan participations indicating that application of the securities laws was unnecessary.

Applicant also cites Smith International, Inc. v. Texas Commerce Bank, 844 F.2d 1193 (5th Cir. 1988). Smith International was decided prior to Reves and relied on a test that was superseded by Reves. Compare Reves, 494 U.S. at 63, 66-67 (describing the four factors) with Smith International, 844 F.2d at 1201 (distinguishing an earlier holding that a note was a security based on "the investment nature of the transaction giving rise to the preexisting debt which the notes represented").

n13 494 U.S. at 66.

n14 The Supreme Court in Reves stated that profit in the context of a note means "a valuable return on an investment, which undoubtedly includes interest." Id. at 68 n.4. See also Pollack v. Laidlaw Holdings, Inc., 27 F.3d 808, 812 (2d Cir. 1994) (fixed rate of return in the form of interest does not rebut the presumption that the notes are securities).
n15 494 U.S. at 66.

n16 The affidavits also state that the customers understood that they would not participate in any profits or income generated by Stoiber, were not getting an interest in stock or any other asset, and were not participating in any form of common enterprise. These factors go to whether, under SEC v. W.J. Howey Co., 328 U.S. 293 (1946), an instrument is an investment contract. The Supreme Court in Reves rejected application of the Howey test to notes. 494 U.S. at 64.

n17 Id. at 66.

n18 Stoiber admitted he has a fiduciary responsibility to these customers.

n19 See generally SEC v. Ralston Purina Co., 346 U.S. 119 (1953) (registration requirements apply to a "public offering" whether to a few or many.) See also Deal v. Asset Management Group, Fed. Sec. L. Rep. (CCH) P 97,244 (N.D. Ill. 1992) (offering to six investors considered sufficient to constitute a broad segment of the public and survive defendant's motion to dismiss).

Applicant also claims that the notes at issue fail the second Reves factor because of the absence of what the Reves Court described as "common trading for speculation or investment." 494 U.S. at 66, citing SEC v. C.M. Joiner Leasing Co., 320 U.S. 344, 353 (1943). Prochaska & Associates v. Merrill Lynch, 798 F. Supp. 1427 (D. Neb. 1992), on which Applicant relies, however, involved short-term promissory notes secured by a lien on a small business that were issued to a single plaintiff. In contrast, here there was no individual negotiation of the terms, nor ability to assess Stoiber's credit worthiness by any of the thirteen customers.

n20 Applicant cites the following cases in support of the assertion that state law can provide a sufficient remedy: Heine v. Colton, 786 F. Supp. 360 (S.D.N.Y. 1992), later opinion 856 F. Supp. 191 (S.D.N.Y. 1994); Reeder v. Succession of Palmer, 736 F. Supp. 128 (E.D. La. 1990), aff'd. mem., 917 F.2d 560 (5th Cir. 1990); and Singer v. Livoti, 741 F. Supp. 1040 (S.D.N.Y. 1990). But cf. Grady A. Deal v. Asset Management Group, Fed. Sec. L. Rep. (CCH) P 97,244 (N.D. Ill. 1992); Pollack v. Laidlaw Holdings, Inc., 27 F.3d 808 (2d Cir. 1994), cert. denied, 513 U.S. 963, 115 S.Ct. 425 (1994).

We note that the cases on which Reves relied in discussing this factor, 494 U.S. at 69, involved alternative schemes of federal regulation. See Marine Bank v. Weaver, 455 U.S. 551, 558 (1982) (federal regulation of banks and FDIC insurance); International Brotherhood of Teamsters v. Daniel, 439 U.S. 551, 569-70 (1979) (ERISA). Applicant does not cite a particular provision of state law and has not demonstrated whether state law can be the source of such alternative protection.

n21 See also William Louis Morgan, 51 S.E.C. 622, 627 (1993); William F. Wuerch, 50 S.E.C. 811, 812 n 2 (1991). See also Darrell Jay Williams, 50 S.E.C. 1070, 1071-72 (1992).

n22 Applicant claims that the NASD is attempting to regulate registered representatives' activity concerning borrowing funds from customers, without having a rule that expressly governs this conduct. Applicant also asserts that, because the NASD issued Notice To Members 94-93 in December 1994, proposing a rule governing registered representatives lending to or borrowing from customers, it indicates the practice was not covered by prior NASD Rules.

Applicant is incorrect. As discussed above, we have found that the notes at issue are securities. Stoiber had a duty under Article III, Section 40 to advise his Firm of these securities transactions in writing. Stoiber's violation of Article III, Section 40 also constitutes a violation of Article III, Section 1. Steven Theys, 51 S.E.C. 473, 480 (1993). For the same reason, Stoiber's reliance on Robert J. Jautz, 48 S.E.C. 702, 704 (1987) is inapposite. There, we held that failure to repay a loan from a customer is not inconsistent with just and

equitable principles of trade, absent bad faith or unethical conduct. Here, the gravamen of the violation is not the failure to receive or repay a loan but the failure to give prior written notice of the transaction to AIS. Compare Robert J. Jautz, id. with Terry Wayne White, 50 S.E.C. 211, 214 (1990) (registered representative took unfair advantage of elderly customer for personal gain by borrowing money from customer who wanted safe investments).

n23 Stoiber also asserts that the NASD did not give any weight to the fact that he spoke with his compliance director about these notes prior to their issuance. We note that Stoiber spoke generically about obtaining loans, but did not give written notification before each transaction. We have considered all the facts, including his conversation with the compliance director, in evaluating the sanctions.

n24 Stoiber wrongly asserts that he will necessarily be liable for combined fines and restitution totaling $ 900,000. The NASD fine of $ 450,000 was to be offset by any amount paid in restitution within 60 days. Therefore, if Stoiber pays that restitution in a timely manner there will be no fine.

n25 See generally Anthony J. Amato, 45 S.E.C. 282, 285 (1973).

n26 All contentions have been considered. They are rejected or sustained to the extent that they are inconsistent or in accord with the views expressed in this opinion.

In the Matter of the Application of GERALD JAMES STOIBER 19140 Kristine Trail Mokena, Illinois 60448; For

Review of Disciplinary Action Taken by the NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

Admin. Proc. File No. 3-8992

SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934 Release No. 34-39565

January 22, 1998

On September 22, 1997, we issued an opinion, from which Commissioner Hunt dissented, sustaining the findings of the National Association of Securities Dealers, Inc. ("NASD") that Stoiber violated Article III, Sections 1 and 40 of the NASD's Rules of Fair Practice ("NASD's Rules"). n1 Stoiber sold securities in the form of promissory notes to thirteen of his securities customers without giving prior written notification to the member with which he was associated, American Investment Services, Inc. ("AIS"). Stoiber now petitions us to reconsider our findings and conclusions, claiming that the NASD did not prove that the notes at issue were securities, that we reversed the burden of proof applicable in a self-regulatory organization disciplinary proceeding, and that he was therefore denied due process. NASD Regulation, Inc. opposes Stoiber's Petition for Reconsideration.

Stoiber admitted that he had issued notes and that he did not give AIS prior written notice. The remaining issue was

whether the notes constituted securities. Stoiber claims that, in concluding that the notes were securities, we did not cite any of the evidence adduced by the NASD staff, but rather limited our analysis to criticism of the evidence adduced by the Applicant. However, as required by Section 19(e) of the Securities Exchange Act of 1934, we undertook a de novo review of this matter. Accordingly, we independently analyzed the evidence in the record, including testimony, the notes themselves, the customers' affidavits, and the customers' files at AIS.

Many of the facts that were significant to our determination that the notes were securities are highlighted in our opinion. For example, we noted that Stoiber issued these notes to individuals who were his AIS customers, in order to engage in commodities transactions and to pay his personal expenses, and that the customers expected to receive a favorable interest rate on the notes at issue. Stoiber made the same general representations to these customers. The customers did not negotiate individualized terms for their investments, did not obtain financial information from Stoiber, and were not in the business of making loans.

Our analysis of these facts was guided by the Supreme Court's decision in Reves v. Ernst & Young, 494 U.S. 56 (1990). Reves adopted a "family resemblance" test for determining whether notes are securities. In that case, the Court explained that there is a presumption that notes are securities. Such a presumption may be overcome if the notes have a strong resemblance to certain types of notes recognized as being outside the investment market regulated under the securities laws n2 or should be added to the list. n3 We weighed the evidence presented and considered all of Stoiber's contentions. We concluded for the reasons stated in our

opinion (including Stoiber's relationship with AIS's customers, the limited information that the customers received, and the rate of return that they were promised) that these notes were securities. We do not find that Stoiber has been denied due process.

Stoiber also contends that our reliance on Reves has reversed the burden of proof applicable in a self-regulatory organization disciplinary proceeding. n4 As noted, the Supreme Court stated in Reves that there is a presumption that notes are securities. Stoiber observes that a self-regulatory organization is required to prove its case by a preponderance of the evidence. He asserts that our consideration of the Reves presumption reversed this burden of proof.

Stoiber, in his brief to us, urged application of the Supreme Court's analysis from Reves. In any event, we are governed by the Supreme Court's opinion in Reves in determining how to analyze the notes at issue to determine if they were securities. While, under Reves, there is a presumption that notes are securities, we believe that the Supreme Court made clear that the presumption was rebuttable. n5 The NASD was required to show that the notes at issue were securities by a preponderance of the evidence. n6 We found that the evidence developed in the record demonstrated that the notes at issue were securities, concluding that "the factors described in Reves do not suggest that these notes should be excluded from regulation under the securities laws" and finding that "we believe the other prongs of Reves are also satisfied." At all times the burden of persuasion remained with the NASD as to whether Stoiber's conduct violated Article III, Sections 1 and 40 of the NASD's Rules. n7 In sustaining the NASD's findings that the notes were securities, we examined the entire

record and applied all of the factors set forth in Reves. We found that the preponderance of the evidence supported the disciplinary action. n8

Accordingly, IT IS ORDERED that the petition for reconsideration filed by Gerald James Stoiber be, and it hereby is, denied.

By the Commission.

Commissioner HUNT, concurring:

I dissented from the Commissioner's September 22, 1997 opinion regarding Mr. Stoiber because I was unable to determine on the record before us whether or not the instruments in question were securities. I still hold that view. Nevertheless, I support today's holding that there is no reason for the Commission to reconsider our findings and conclusions from that September day. The Commission carefully considered on a de novo basis whether or not the instruments were, in fact, securities. The Commission also properly applied Reves. Mr. Stoiber was not denied due process and, therefore, I see no reason to reconsider his case.

Footnotes

n1 Gerald James Stoiber, Securities Exchange Act Release No. 39112 (September 22, 1997), 65 SEC Docket 1309.
n2 Id. at 65. The Supreme Court believed that the following notes are not securities: the note delivered in consumer financing; the note secured by a mortgage on a home; the short-term note secured by a lien on a small business or some of its assets; the note evidencing a character loan to a bank

customer; the short-term note secured by an assignment of accounts receivable; the note that simply formalizes an open-account debt incurred in the ordinary course of business; and the note evidencing a loan by a commercial bank for current operations.

n3 The four factors to consider in determining whether the notes are not securities are: (1) the motivations that would prompt a reasonable borrower and lender to enter into the transaction; (2) the plan of distributing the notes; (3) the reasonable expectations of the investing public regarding whether the instruments were securities; and (4) the presence of any alternative scheme of regulation or other factor that significantly reduces the risk of the instrument so as to make regulation under the securities laws unnecessary. 494 U.S. at 66-67.

n4 We assume that Stoiber refers to the burden of persuasion, i.e., the requirement that the case be proved by a preponderance of the evidence, not merely the burden of going forward to produce evidence.

n5 Reves v. Ernst & Young, 494 U.S. at 64.

n6 See, e.g., Western Capital and Securities, Inc., 50 S.E.C. 247 (1990).

n7 See James M.Bowen, 51 S.E.C. 1152, 1154 n.9 (1994)(After the NASD demonstrates a prima facie case, applicant is required to come forward with evidence. The burden of persuasion remains with the NASD.).

n8 The proper standard to be applied is the preponderance of the evidence standard. See, e.g., Steadman v. SEC, 450 U.S.

91, 101 (1981); Seaton v. SEC, 670 F.2d 309, 311 (D.C. Cir. 1982); Ernest A. Cipriani, Jr., 51 S.E.C. 1004, 1006 (1994); Kirk A. Knapp, 50 S.E.C. 858 (1992).